DOW THEORY LETTERS INC.

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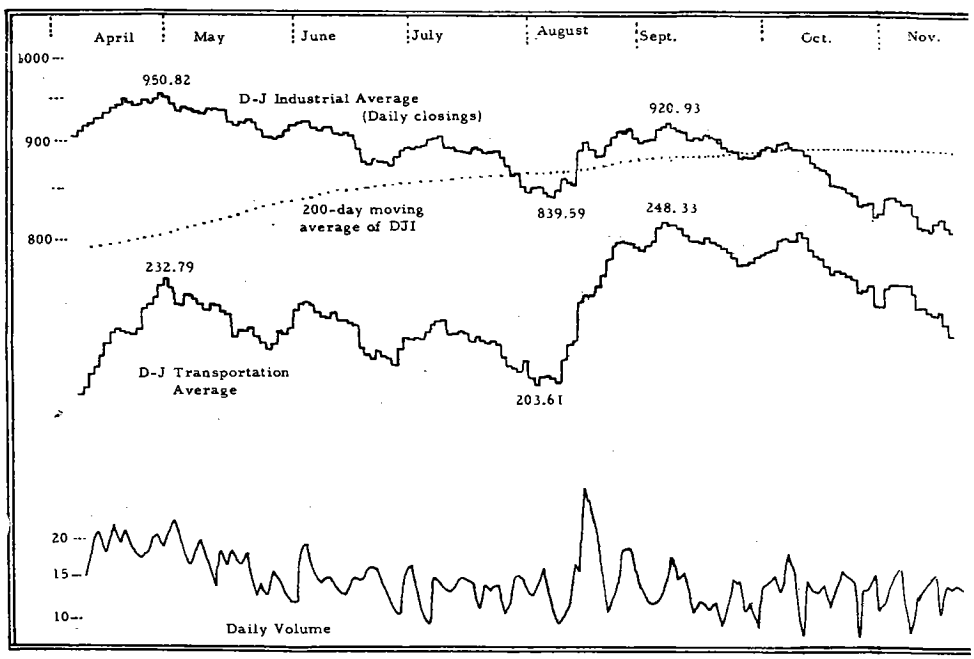
THE MARKET: It has been a generation since Americans have seen a great primary bear market in "full force". True, the 1969-70 cave-in was hardly a birthday party, but I do not consider that the 1969-70 action constituted a bear market crash either. At no time was liquidating volume during 1969-70 of massive proportions, at no time was the market thoroughly demoralized, at no time were stocks thrown in "for what the market will bring", at no time did margin calls set off "disorderly markets".

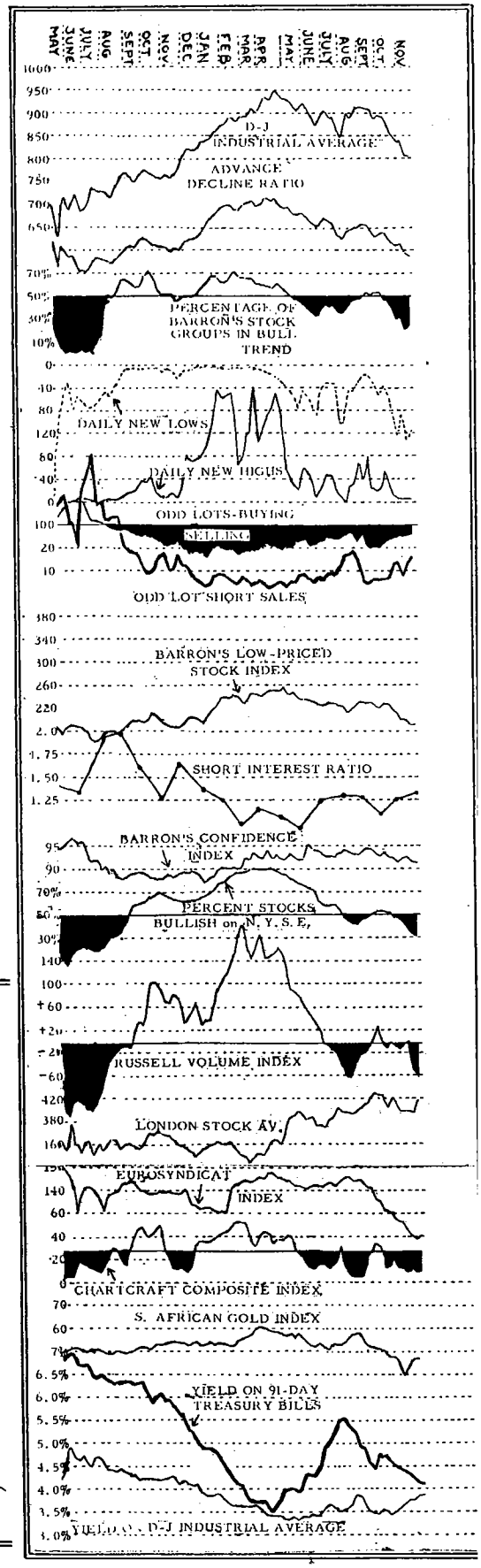
I believe that we will see something resembling a true crash before this primary bear market breathes its last. The August 16 trading on the upside (following Mr. Nixon's speech) set an all-time volume record of 31.7 million shares. I believe we will see new volume records set on the downside before this bear market is through.

On November 19 both Averages broke badly, with Industrials closing within pennies of a new low for the year and Transports at new lows for the decline which began at the September peak (see chart at bottom of this page). On Monday (Nov. 22) the market sold lower, with Industrials this time sinking to a new 1971 low.

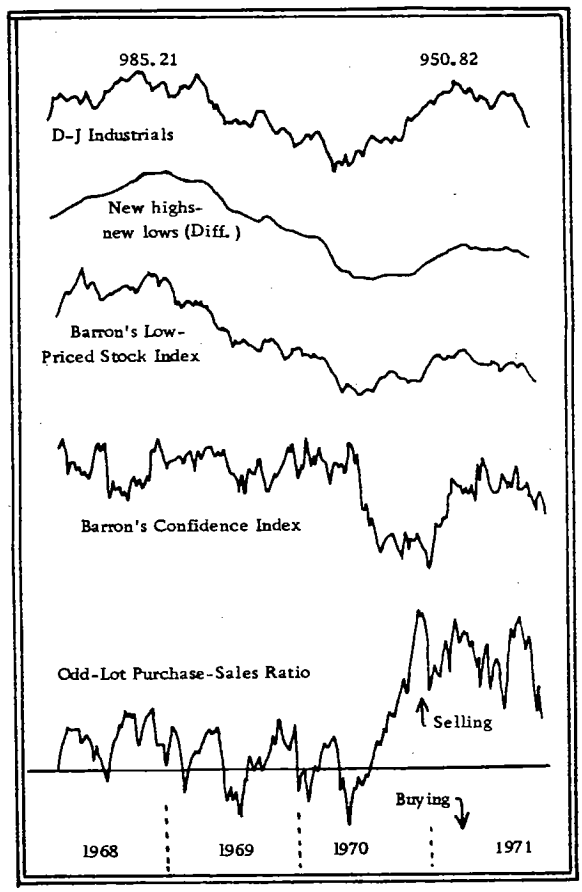
At this point, all eyes should be glued to the August 4 Transportation low of 203.61. Why? Because Industrials penetrated their own August lows a few weeks ago, and it now remains for the bear to send the Transports through their own August lows. If this occurs, the last vestige of technical support for this market will have vanished.

The recent little rally in the Utilities may now be over, and it will be worth watching to see if the Utility Average cracks its October low for the year at 109.18. Finally, the advance-decline ratio, which has been telling a bearish story ever since last April, is currently at a 1971 low, and actually at its lowest level since mid-August, 1970 (at which time the Dow was in the 715 area). Thus the current level of the A-D ratio allows for a continuing collapse in the Dow, while a Transport violation of 203.61 would break the back of the entire movement since mid-1970.





The truth is that this market is now sick, very sick, and it is building a downside momentum which may soon be "unstoppable". I noted in previous Letters that the one ingredient that our economists and Washington leaders cannot feed into their econometric models is crowd psychology, and I feel that mob psychology is now very close to taking over Wall Street. If it does, we will shortly be embroiled in one of those rare, once-in-a-generation phenomenons, the primary bear market crash.



I am including a chart covering five important indicators from the period of 1968 to the present (chart drawn from graph in Comparative Market Indicators, P.O.Box 1557, Bellevue, Wash. 98009). The top line traces the Dow Industrials from the 985.21 peak of 1968 to the present. The Dow is presented for comparison purposes.

Now note that the new high-new low differential line failed by a wide margin during 1970-71 to come anywhere near its peak of 1968. This was true even though the Dow advanced in 1971 to within 35 points of its 1968 high. Thus, from the standpoint of new highs, the 1971 effort was vastly inferior to 1968.

The Low-Priced Stock Index touched a high of 413 at the 1968 top. After collapsing during 1969-70, the L-P Index got no higher than 245 in 1971. Currently it is below 200. This indicates that the public, badly mauled during the 1969-70 smash, did not come back during the 1970-71 advance. It is the public which generally purchases the speculative low-priced "cats-and-dogs". Without the public, 1970-71 produced only a token rise in the L-P Index. As I have said many times before, this is par for the course during a primary bear market. Once the low-priced issues top out, they are finished for the remainder of the bear market. I would guess that the 413 high of 1968 on Barron's L-P Stock Index will stand for many years — or until the late stages of the next primary bull market.

Confirming the low-priced stock observations, note that the odd-lot public moved to the selling side during mid-1970, and they have stayed there ever since. Having been mangled during the 1969-70 collapse, the odd-lotters (indicative of the general public) have "had it" with Wall Street, the high-priced stocks, the medium and the low priced stocks, the funds and everything else. They want "out", and the odd-lot statistics prove it.

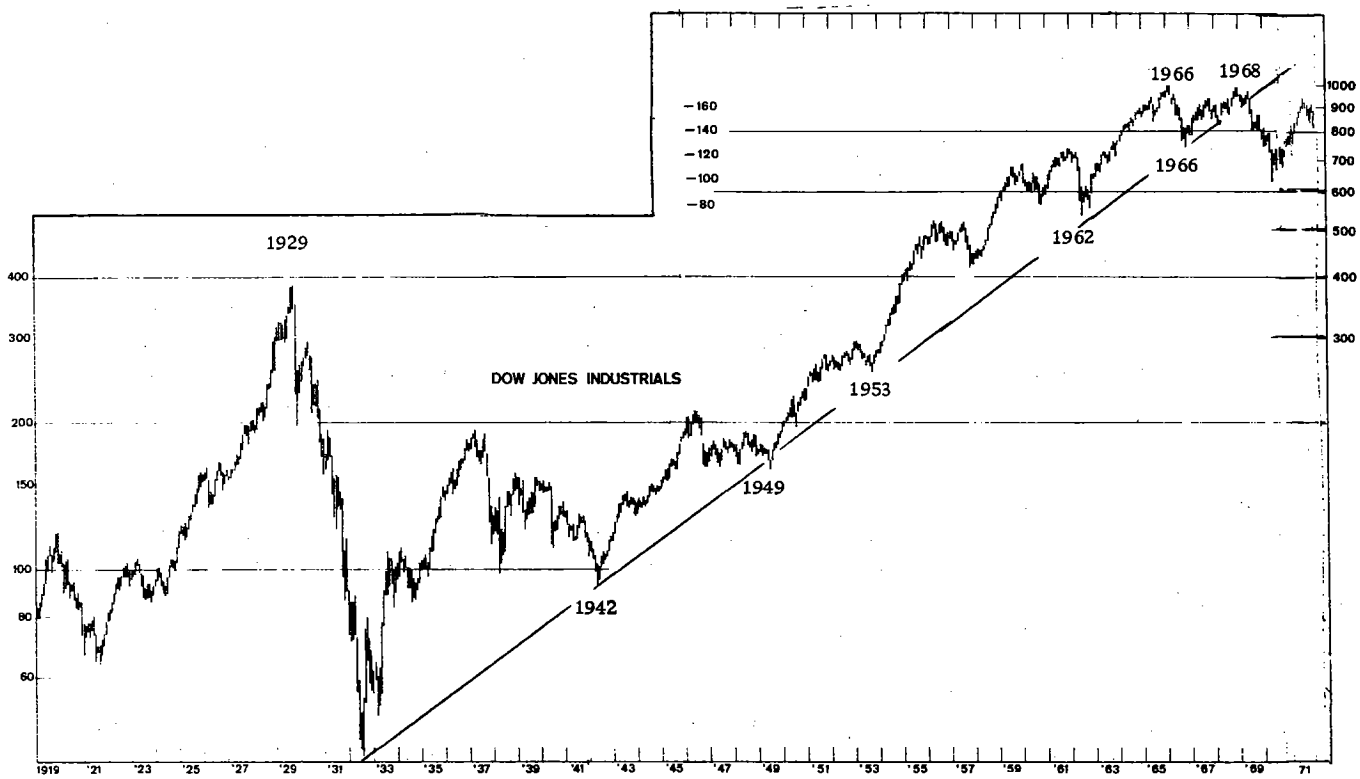
Ironically, however, the most recent odd-lot figures show less selling now than at any time since late-1970. This is not a plus for the market, and it suggests that the lower prices since April, 1971, brought less concern, not more worry, in odd-lot circles. I therefore rate the odd-lot picture negative, since the trend is to less selling (or towards buying).

Finally, Barron's Confidence Index broke down towards late-1970 (giving a good advanced warning signal which nobody noticed, since few people now watch the C.I.). The 1971 rally in the C.I. halted well below the 1969-70 peak level, and last week the C.I. again broke below its recent lows to a reading of 91.2. Nothing bullish here.

PERSPECTIVE: People look at the daily chart of the Averages in the Wall Street Journal, and they forget where we are. Sometimes a study of a long-term chart can shatter illusions. The page 3 chart is through courtesy of the Bank Credit Analyst, and I have taken the liberty of drawing in a most extraordinary trendline. The trendline extends from the 1932 low of 41.22 on the Dow through the 1942, 1949, 1953, 1962 and 1966 bottoms. This 37-year trendline was cracked in 1969.

Note that all the bear market action since the trendline violation has taken place under the trendline. Thus, the Dow since 1969 has been unable to regain the "rate of growth" which has sustained it ever since 1932. To my mind, this is a most critical change. Something momentous has occurred.

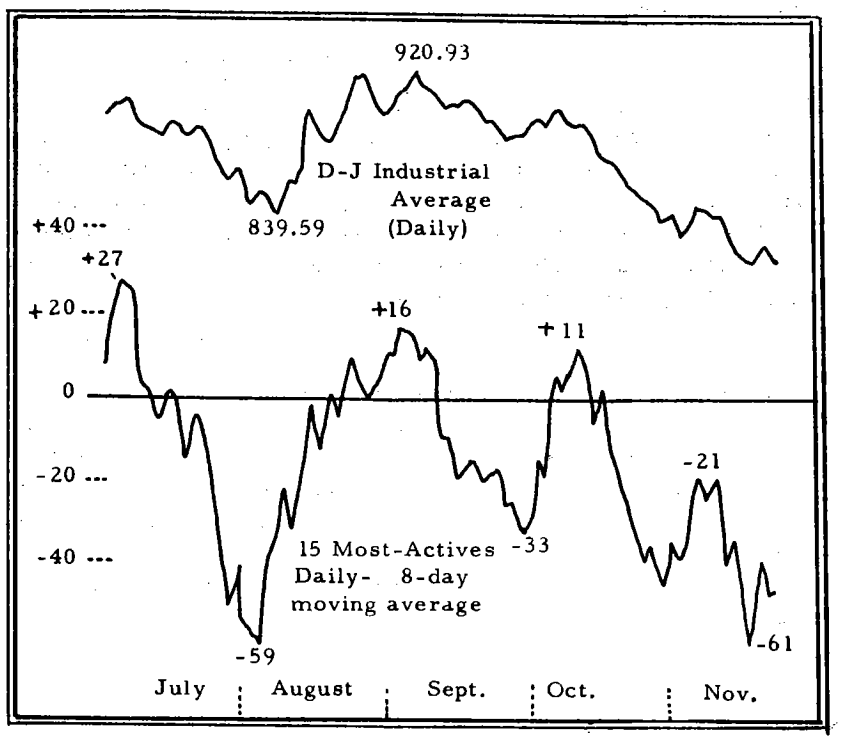
I received quite a few letters expressing amazement at my statement that I believe this primary bear market could carry down to the 300-400 area before it was over. That must appear to be a "wild" estimation.



But make a mark on the 350 level on the chart. Now compare the level of the 350 mark with the level of the Industrial Average back through the years to 1929. Does the 300-400 level look too low? Does it look totally out of sight on the downside? Unfortunately, it does not. Remember, the 1953 reaction low was 295, almost double the distance from the 1949 bull market bottom of 161.

No, I would say that the 300-400 level could easily be obtained as this bear market corrects all the excesses in U.S. finance and industry which have occurred since 1949. Of course, this will take time and produce many new and bearish phenomena. All of this will take place against a background of continual Government manipulation and probably many "wild" new Administration innovations. Nevertheless, as I have been saying all along, the bear will express itself. His claws will sink deep into the throat of the bull and he will tumble down the market. It has always been that way, and the bulls this bear is clawing are the fattest, the most over-weight, the sickest bulls in American history. They will make a great noise when they fall.

MOST ACTIVES: In Letter 509 I presented my new daily chart of the most-active stocks on the N.Y.S.E. This is a chart of the daily pluralities of the 15 most active stocks, arranged in the form of an 8-day moving average. The significance of this chart is that over any reasonable length of time, the most active stocks tend to make up about 15% or more of total N.Y.S.E. volume. Historically, the trend of the action in the most active issues tends to precede action in the rest of the market.



Studying the chart, it is apparent that the trend of the most-actives has been decidedly on the downside. The brief exceptions occurred during July, September and October, 1971, when the most-active index rose temporarily to the plus side of the ledger. However, it is significant that each of the plus readings were below the last as seen on the chart (plus 27 in July, plus 15 in September, plus 11 in October). In November, the best reading so far has been a minus 21!

Of particular interest is the overall count on the daily most-active index. Of the 101 trading days since July 1, only 29 have shown a plus. This means that better than two-thirds of all the sessions since the third quarter began have indicated selling pressure and distribution as measured by the most-active index. This is hardly a pleasant situation, but it should serve as a warning and testament to the simple fact that bear markets are made for the purpose of distributing stocks. To ignore that fact is to court disaster in the market place.

ECONOMIC NOTES: A new spectre is now haunting South Vietnam. The economy there is in the worst shape since the Americans arrived, and prices are up as much as 30% over the last few weeks. The price of gold has boomed to $80 per ounce, and on November 14 (with the government printing masses of new money) Vietnam devalued its currency by a whopping 45%.

Secretary of the Treasury John Connally is sinking into deeper and deeper trouble. I wrote at the time of the Connally appointment that I felt the job called for a man of great skill, experience and intelligence in all phases of domestic and international finance. Mr. Connally, a shrewd Texas politician, did not even begin to fit the bill. Although the current monetary mess is not of Mr. Connally's making, I believe he is totally out-of-his-water and thoroughly incompetent by way of solving it.

He cannot continue to put off his meeting with the European Group of 10. Every passing week brings Europe nearer to joint agreement on a policy (despite Connally's flagrant attempt to split Germany from its partners with a plan for removal of the 10% surcharge on German exports). When a Group of 10 policy is reached, it will be a strong united policy and may well force Connally's hand. If the present confrontation becomes downright nasty, a trade war could easily result with dire effect on world commerce (which is heading into a slump now).

Evidently, the Nixon-Connally plan is to "divide and conquer". They are hoping for a few unilateral agreements with individual countries. They are banking on the U.S. being less affected by trade pressure and floating currencies and restrictions than other nations, and a few of those nations may "throw in the towel", thus leading the way to a U.S. "Grand Slam".

It's a kind of economic "Russian Roulette", and the stakes are the commerce of the world. As late as November 11, Treasury Under-Secretary Volcker (a rabid anti-gold man) stated that "The crucial decisions to permit an early resolution" of currency and trade problems "haven't been made", and an "easy and quick" solution does not exist. On November 13, following a 17-day trip to Asia, Mr. Connally told newsmen that the present situation with most of the world's currencies floating against each other could go on "almost for an indefinite period of time". He stated that it would do little harm to the U.S. "We're doing very well", he said. Thus the U.S. continues to wage its war of nerves.

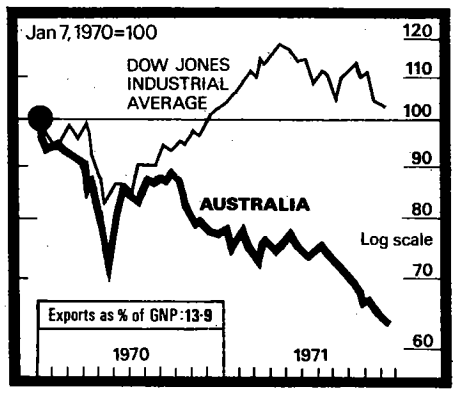
Meanwhile, Mr. Connally has been saying that the deficit for fiscal 1972 (year ending June 31) will be $26 billion. Believe it or not, this estimate is based on a $10 billion rise in corporation tax collections. My own feeling is that the deficit will be nearer $40 billion or higher. How will the money be raised? By bonds? By printing press? Or will there be new taxes? At any rate, a huge new deficit in the face of a sliding business picture (to me) spells disaster for the Administration.

The Pay Board has announced that corporate prices could be raised 2.5% annually, assuming that boosts do not raise a company's pre-tax profit margins. With many prices going down, this is no great spur to the economy, but it should be viewed in the light of what I wrote in the last Letter about "flation", which is a rise in costs in the face of a decline in prices. That is where this nation is now, the resultant squeeze is being reflected in the collapsing prices of common stocks. People have grown so used to prices going up that they feel it can occur simply as a matter of course. Forget it, there is a metals glut, a housing glut, an auto glut, a glut in almost every area of the economy. The era of booming prices is over. At the moment, due to Labor's unbelievable power, only costs are rising.

Although the "public" ostensibly swarmed in to buy new cars before the mid-November date for price increases, the professional purchasing agents did quite the opposite. In a November 17 Wall Street Journal story, it is stated that instead of loading up on all the price bargains, "....the purchasing men held onto their cash". This is termed "a blow to hopes for an upturn". The whole trend was hardly food for the bulls, since one of the prime reasons for sluggishness in the current "upturn" has been the refusal of business to build its inventories. Reasons given were high cost of holding inventory, high cost of insurance, and already heavy inventories. Also mentioned was the feeling that many suppliers would have trouble holding their prices, much less raising them. Despite the public's fears, professional businessmen seem to think that deflation in prices, not inflation, is in the wind.

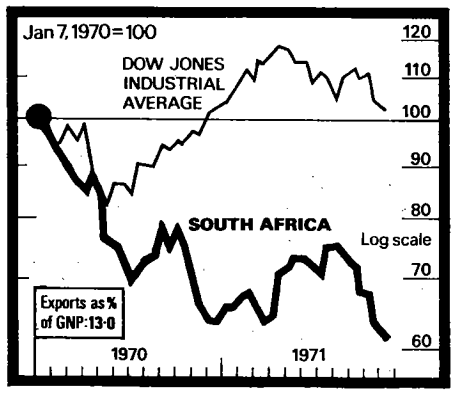
The world recession, which I wrote about extensively in Letter 510, continues on its ominous course. Shipbuilding is a good indicator of world commerce. The shipbuilding industry is in a slump which is deepening. The world shipbuilding order book for the third quarter increased by only 400,000 tons, as against 5 million tons a year ago. Commodity prices are sinking around the globe, bringing depression to developing nations. For instance, natural rubber prices are at their lowest level in 8 years. Cocoa is at its lowest since 1966. The European steel industry is in its worst straits since World War II. Copper prices are falling, despite rising capacity. Nickel prices have caved in, with International Nickel (after cutbacks of 22%) talking about a third cutback.

Two stock markets, more than any others, reflect coming events in minerals and metals. These are the stock averages of South Africa and Australia. The accompanying charts show the markets of these two nations as compared with the D-J Industrials (Jan. 7, 1970 equals 100). Remember, the S. African average is not the gold average, it is the S. African industrial average.



The U.S. balance-of-payments for the third quarter set a record $12 billion deficit, a deficit bigger than that of all 1970.

GIANT: With Britain's vote to join the Common Market, the power structure of the world has significantly changed. Almost monthly, it seems, the once-unmatched power of the U.S. seems to shrink while the power of the rest of the world expands. With the British entrance to the Common Market, it means that the new Common Market will have a GNP of $621 billion against the U.S.'s $974 billion. But the Common Market will have more than twice as much gold in its reserves as the U.S. (which if it paid off its debts would actually owe billions in gold to the rest of the world). The Common Market will be doing one-third of the world's trading vs. 14% for the U.S.



At the same time (and I feel this is significant) the U.S. took its most humiliating beating at the hands of the United Nations as Red China was admitted and as Nationalist China was ejected (all to the tune of many delegates dancing in the aisles). Finally, in a surprise Senate vote, the U.S. Foreign Aid bill was scrapped for the first time in a quarter of a century, to the consternation and shock of most of the world (particularly the undeveloped nations).

Many may see these events as isolated items, each having no bearing on the other. I do not see it that way. I see the momentous events of the past few weeks as a stern warning to the U.S. After years of profligacy and over-spending, after decades of piling up debt after debt, the time of reckoning is finally approaching. As far as I know, at no time in the history of the world has a country suddenly halted as it skipped along the primrose path, stopped dead in its tracks, and decided to repent and change. Sad but true, profligate nations either topple as other nations rise, or they succumb to internal gaps and cracks which are caused by the rot in their own internal structure.

I don't profess to know where the U.S. is going as it follows the path to its destiny, but I do feel that the clouds of history are getting darker. Instead of being a shining example to the world of a great nation which puts morality above all, the U.S. has staggered under the combined loads of greed, over-abundance and a retreat into semi-fantasy. Meanwhile, the rest of the world has to some extent learned from the lessons of the past. They have attempted to build real wealth backed by gold, they have attempted to solve some of their real problems by pooling their resources and their knowledge.

This is not to say that the U.S. is all wrong and the rest of the world is all right. Far from it. But we have not done our part, we have not used our heads, we have not once halted on the greedy road to super-abundance, even though that road meant a veritable orgy of ugly construction, a desecration of the land, a turning away from real values and a turn towards pleasure and self-satisfaction.

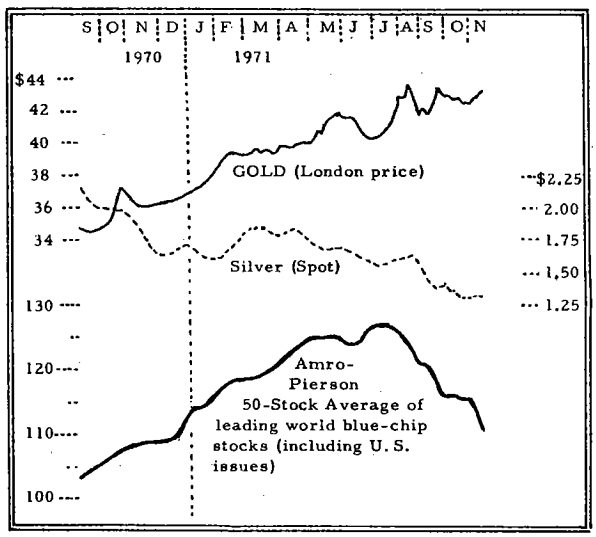
The U.S. has been the wealthiest nation in the world, it has had every opportunity to use its wealth (and its intelligence) as a model for the rest of the world to admire and be inspired by. And there is no doubt about it, there is much in the U.S. which is admirable and inspiring. But perhaps it was Vietnam, perhaps inflation, perhaps a thousand things; whatever it was the U.S. dream became tarnished and as measured by the flow of gold its life blood began ebbing away.

I feel that we are nearing the day of reckoning, and maybe that will be just as well. For what is needed in this country (in my opinion) is a re-examination of everything we live by, a re-thinking of our lives, our goals, our standards, our morality.

Kris Kristofferson, one of the U.S.'s top contemporary folk singers says in one of his new songs, "The devil haunts a hungry man". Maybe we will have to get a bit hungry before we can confront our devil. When we confront him, we will have a chance to beat him. But you can't beat the devil if you can't see him. And that's what lies ahead.

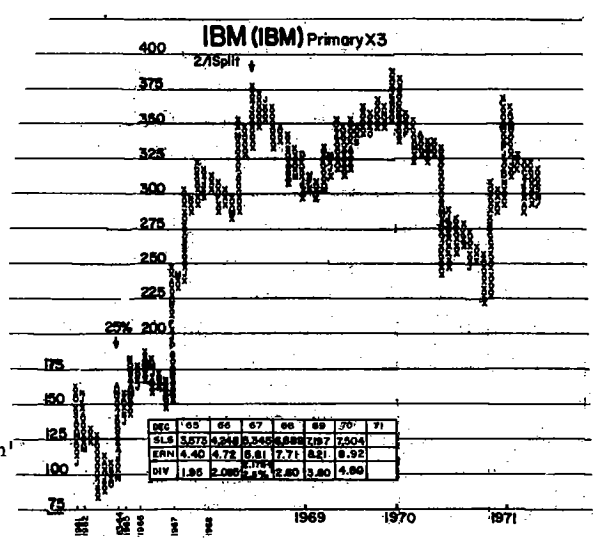
As I finished the above I received Market Indicators Digest, an excellent investment service dealing with the South African and world markets and written by Fred Macaskill (P.O. Box 23244, Johannesburg, S.Africa). Fred is one of the people who agrees with me on the big picture, and this is the way he puts it in his latest report: "I regard the major international bear market as being inevitable. I accept this. I also accept that nothing can prevent it. The fundamentals for it have already been created and cannot be undone. I attach no blame to any one who contributed over the past 30 years in the creation of these fundamentals. It is inevitable that they should have done so. I cannot blame any one for not having seen these fundamentals for what they are — it is inevitable that most of us did not see it, how else could the situation have developed?"

GOLD AND GOLD SHARES: On November 12 the price of gold on the London market touched a two-month high of $43.25 (see chart). Meanwhile, the S. African (and other) gold shares appear to have hit bottom and are starting up again. The earnings of many S.African mining shares have risen substantially, and this is based on an average price of $39 per ounce for gold in the second quarter. For instance, in the second quarter earnings of Hartesbeestenfontein were up 33%, Kloof up 26%, President Brand up 16%, Vaal Reeffs up 25%, West Driefontein up 10%, Western Deep up 27% and St. Helena up 19%. During the third quarter (see chart on gold price) the average price of gold was above $39, and during the current quarter the average price will be above $42.



As the world sinks into economic depression, the case for a doubling or more in the price of gold will loom larger and more insistent (see Barron's, Nov. 22, page 3). The token 10% rise in the gold price being mulled over by the Administration will not even serve as a stop-gap measure. As for the case for a gathering world depression, note that the international Amro-Pierson 50-stock average has dropped on its latest reading to 110, a low for the year. I expect the trend of the gold price and the Amro-Pierson 50 to move in opposite directions for some time to come.

STOCKS: With 114 million common shares at around $300 per share outstanding, IBM is one of the big guns of the market. This point & figure chart (courtesy of Paflibe, 18 E. 41st St., N.Y.C. 10017) shows that IBM has gone along in much the same pattern as the Dow. Here we see what could be a "triple top" and a recent break below 300. Nature often "finishes" things in groups of threes; "three strikes and you're out", or you often knock three times on a door, seldom twice or four times. At any rate, IBM has knocked three times at the 380 area, and now it is back trying to hold above 300. I would say that a decline in IBM to the 280 area would spell the start of a major bear market decline for this great stock. It, like GM, is one of the bellwethers of the market.



OBSERVATIONS: Within a matter of months, the Western Union Telegram will probably be dead. It will be replaced by a "mailgram" a message sent by teleprinter to a post office which will then record the message and deliver the next day in the form of a letter. I used to work for the now-defunct Postal Telegraph Co. when I was a kid. They were merged into Western Union. In those days before World War II, I would come home with a day's pay of 30¢ to a dollar. Therefore, I have mixed feelings about the passing of the telegram. The telegram used to be a great service, and part of my blood is in there somewhere.